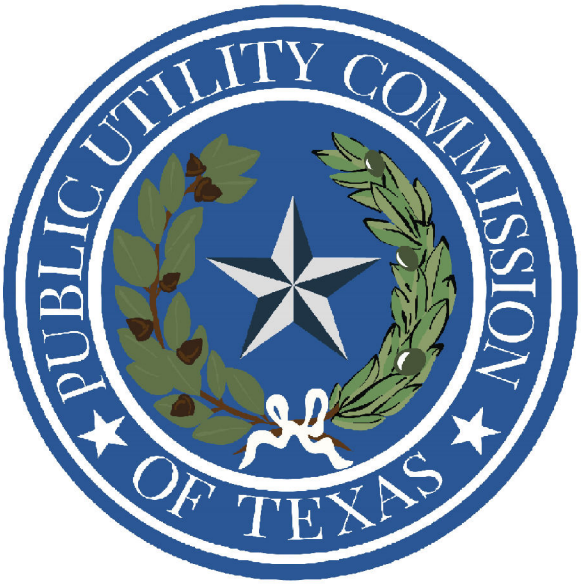

Filing Receipt

Received - 2021-11-01 10:33:31 AM
Control Number - 52373
ItemNumber - 196

PROJECT NO. 52373

REVIEW OF WHOLESALE ELECTRIC MARKET DESIGN	**§**	**BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS**

THE STEERING COMMITTEE OF CITIES SERVED BY ONCOR'S COMMENTS ON "COMMISSION STAFF'S MEMORANDUM" REGARDING REVIEW OF WHOLESALE ELECTRIC MARKET DESIGN

The Steering Committee of Cities Served by Oncor (OCSC) submits these Comments on "Commission Staff's Memorandum" to the Public Utility Commission of Texas (Commission) regarding Project No. 52373, *Review of Wholesale Electric Market Design.*[1] At the request of Chairman Lake in the "Commission Staff Memorandum"[2] and discussed during the October 21, 2021 work session, Commission Staff filed its memorandum requesting comments from interested parties on a series of sixteen questions, with subparts, related to Chairman Lake's list of preliminary key concepts for market redesign.[3] Commission Staff requested comments from interested parties be filed by noon on November 1, 2021. Therefore, these Comments are timely filed.

I. EXECUTIVE SUMMARY

As requested, OCSC has provided a one-page Executive Summary at the end of this submission.

II. COMMENTS

OCSC member cities (Cities) have been active participants in the design and oversight of the ERCOT market for most of the last two decades. Cities have participated in countless contested cases and rulemakings at the Commission. More than one hundred participating Cities are commercial consumer segment members of ERCOT. Representatives of Cities have served on the ERCOT Board of Directors, the Technical Advisory Committee (TAC), and other Subcommittees, Task Forces, and Working Groups. Throughout their participation at ERCOT, Cities have

[1] Commission Staff Memorandum–Request for Comments (Oct. 26, 2021).

[2] Chairman Lake Memorandum regarding ERCOT Market Redesign (Oct 20, 2021).

[3] *Id.*

promoted a fundamental set of market principles, which are highlighted again here and discussed below in the context of the Commission's effort to reform the ERCOT market:

- The fundamental objective of the ERCOT market is to reliably deliver power at the lowest cost;
- Where competitive market solutions are possible, power will be delivered at the lowest cost;
- Cities support competitive market solutions where possible;
- Achieving both reliable and economically efficient markets will necessarily involve tradeoffs;
- A fundamental principle of competitive electric markets is to shift financial risks from customers to capital markets and capital market participants;
- The Commission and ERCOT should maintain policies such that financial risks continue to be borne primarily in capital markets by capital market participants; and
- Market and regulatory certainty combined with transparency of market design and operation enable robust market participation; all market and regulatory modifications should follow robust and transparent procedures that provide due process to stakeholders.

In this project, the Commission is addressing fundamental, complex market design issues that merit full study, consideration of alternatives and comprehensive cost assessment. OCSC's first market principle is that the ERCOT market will deliver reliable power at the lowest cost. OCSC is not convinced that the effort underway will achieve this principle without a fuller, more structured, and more inclusive process. The market in ERCOT was designed over the course of 20 years with detailed and full assessment of alternative proposals. Over those years, issues have been debated fully and with rigor. In fact, the two major ERCOT market designs were conducted before the Commission in contest cases, which allowed for presentation of facts and data, and balanced participation among the intervening parties. The issues under consideration by the Commission today will set ERCOT market policy for many years into the future. OCSC's concluding market principle is that changes should be addressed with transparency and robust market participation following an appropriate process that promotes balanced participation among

all interested parties. These decisions are too consequential not to conduct a comprehensive design and assessment process, which obviously cannot be completed by the end of the year.

At the Commission workshop on October 14, 2021, both PUC consultant Sam Newell of the Brattle Group and David Patton of Potomac Economics explained that the PUC's effort in this project addresses multiple objectives, the first of which is to correct operations to address the failures that led directly to the winter outage, and a second objective is to improve long-run incentives for investment in new dispatchable resources. The Commission has taken key steps in satisfying the first objective, with its rulemaking on weatherization performance and its work jointly with the Railroad Commission to identify critical natural gas loads. Along with reforms adopted at ERCOT, these steps will prevent the occurrence of outages associated with potential future events similar to Winter Storm Uri. OCSC applauds the urgency with which the Commission has addressed last winter's operational failures. This is because the outages resulting from Winter Storm Uri were caused by a failure to winterize power plants. That same urgency, however, is not appropriate, and may be counterproductive, in the Commission's effort to redesign the ERCOT market.

OCSC recognizes the failures of the ERCOT market during the winter storm, and applauds the Commission for taking those first steps to reexamine the market design. As noted in our statement of market principles, OCSC supports competitive market solutions where possible. A properly designed market will deliver reliability at the lowest cost. It will also create incentives for operations and investments that stand the test of time without the need for constant regulatory restructuring. Failure to adhere to market principles creates risks that may be financially damaging to Texans. Investment incentives will not be successful and self-sustaining unless those incentives are foundational and fully integrated into the ERCOT market. And without a self-sustaining incentive structure, the Commission will be forced to constantly adjust the design to shift more market funds to potential investors. Such an outcome will not satisfy the overarching objective of market restructuring to shift investment risk from consumers to capital markets and capital market participants.

In the now months-long dialogue about market design, OCSC is concerned by the lack of discussion of economic efficiency and cost to consumers. Economic efficiency is fundamental to markets. Without adhering to an economic efficiency goal, a true market outcome may not exist; the new design may simply be a set of interrelated products that may or may not work together to

operate at a low cost and to stimulate investment. The consequences of failures in the structure of the market can be great, as evidenced by the effects of Winter Storm Uri. The Commission's rules have relied on the Scarcity Pricing Mechanism (PUC SUBST. R. 25.505(g)) to create an incentive structure to stimulate investment. Unfortunately, during the winter storm, the failure of the Scarcity Pricing Mechanism greatly exaggerated the financial consequences to the industry and to electric consumers. Despite a $9,000 per MWh penalty for failure to perform, the Scarcity Pricing Mechanism did not lead the larger generation community to sufficiently winterize the generation fleet. In addition, the elevated prices experienced during the winter storm failed to create a financial environment for new investment as the potential excess generation revenues were lost to high costs for natural gas. The consequences of poor market design can indeed be catastrophic, as seen after the failure of the Scarcity Pricing Mechanism.

At this time, OCSC recommends that the Commission continue to expand its focus on *operational policies* that directly address the causes and consequences of the winter storm outages. The new winterization rules and identification of critical natural gas loads are key to that response. Similarly, ERCOT has taken steps to include following a more conservative approach to operations, modifying the ERS program, and expanding Ancillary Services participation to uncontrollable loads beginning in the summer of 2022. Additional steps should include, at a minimum:

- Directing attention to the proposed new rule at the Railroad Commission, where all gas infrastructure is treated equally, with no further guidance to the Commission or Transmission Service Providers.[4] The Commission should proactively collaborate with the Railroad Commission to ensure that both agencies have a clear process which outlines procedures and hierarchy when making determinations on critical gas infrastructure.
- Looking forward to Phase II of the Commission's weatherization program and evaluation of Phase I and, in particular, whether ERCOT is successful in conducting rigorous inspections of Generation Resources across the State in the very short timeframe available.

[4] *See* 46 Tex. Reg. 6458 (Oct. 1, 2021).

- Recommending that the Commission take steps to assure the availability of Black Start Units when called upon, a significant reliability risk revealed during the storm.
- In addition, recommending that the Commission study and consider recommendations for improvements in infrastructure, *e.g.*, sectionalization, or systems applications to improve the ability of distribution utilities to implement outage protocols.
- Remaining open to other policy topics that can be assessed and implemented in the near term to prepare for and improve operations during extreme winter events.

In addition to addressing operational issues as previously recommended, OCSC recommends the Commission direct its immediate attention and resources to the more direct and timely set of potential market changes that are unlikely to develop unintended consequences, such as Real-time Co-optimization and Battery Energy Storage, which have already been evaluated in a comprehensive multi-year stakeholder process. The list of such changes under discussion may include:

- Restructuring ERCOT's Ancillary Services lineup and, in particular, incorporating Fast Frequency Response Service and ERCOT Contingency Response Service.
- Taking additional steps to incorporate Demand Response into the ERCOT market.
- Continue emphasizing Real-time Co-optimization.
- Facilitating opportunities for Energy Storage Resources to integrate into the market, both for the inherent flexibility of those resources and the potential for firming intermittent resources.
- The Commission should also focus on accelerating transmission access to West Texas, as it has done recently in the Lower Rio Grande Valley. Expanded transmission access to the West will release already existing resources bottled up behind the West Texas Generic Transmission Constraint.

In its recent comments in PUC Project No. 52363, OCSC supports resetting the High Offer Cap to a lower value. That step should not be taken in a vacuum. OCSC supports additional restructuring of the parameters of the Operating Reserve Demand Curve (ORDC) to assure sending investment signals without relying on crisis pricing, an issue of emphasis by Chairman Lake. OCSC, however, agrees with the comments of Dr. Patton from the October 14th workshop that the ORDC modifications should be based on economic principles and data evaluation.

At this time, OCSC does not support moving ahead with the proposed Load Serving Entity (LSE) Capacity Obligation. This concept would represent a major shift in the policies underlying the Texas competitive market. It has not been demonstrated that ERCOT suffers from an imminent capacity sufficiency crisis, and it has not been established that capacity insufficiency caused the winter outage. While there were many contributors to the outage, the root causes were natural gas availability and the lack of power plant winterization.[5] It is not clear that more resources would have prevented the outage without improved winterization and additional access to natural gas supply.

ERCOT's most recent projections for the upcoming winter and for the summer of 2022 suggest that there is not an imminent capacity shortage. The most recent Capacity Demand and Reserves Report (CDR) projects a summer Reserve Margin for 2022 of 28.8 percent.[6] Similarly, the CDR projects a winter 2022/2023 Reserve Margin at peak of 42 percent. Both are above ERCOT's Reserve Margin target of 13.75 percent, and significantly above the Economically Optimal Reserve Margin, *i.e.*, the level of capacity that minimizes total system capital and production costs, of 11 percent estimated for ERCOT by Astrape Consulting.[7]

ERCOT already discounts wind and solar capacity based on historic data in the CDR. Yet, even excluding intermittent wind resources entirely, there is *still* excess generating capacity on the ERCOT system. Assuming zero wind resources over the Summer 2022 peak,[8] the CDR projects a healthy Reserve Margin of 16.18 percent, well above the current target and the Economically

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[5] *See* The University of Texas at Austin–Energy Institute Report: The Timeline and Events of the February 2021 Texas Electric Grid Blackouts– July 2021 https://energy.utexas.edu/sites/default/files/UTAustin%20%282021%29%20EventsFebruary2021TexasBlackout%2020210714.pdf; *See also* Federal Energy Regulatory Commission (FERC) and North American Electric Reliability Corporation (NERC) Joint Staff Inquire: February 2021 Cold Weather Grid Operations: Preliminary Findings and Recommendations https://www.ferc.gov/february-2021-cold-weather-grid-operations-preliminary-findings-and-recommendations.

[6] *See* http://www.ercot.com/content/wcm/lists/219841/CapacityDemandandReservesReport_May2021.xlsx.

[7] *See* Astrapé Consulting: Estimation of the Market Equilibrium and Economically Optimal Reserve Margins for the ERCOT Region for 2024 (Jan. 15, 2021 http://www.ercot.com/content/wcm/lists/219844/2020_ERCOT_Reserve_Margin_Study_Report_FINAL_1-15-2021.pdf.

[8] Assuming zero wind capability in the most recent CDR summer 2022 forecast will reduce Total Capacity by 9,641 MW to a forecasted Total Capacity of 89,076 MW. Based on a Firm Peak Load forecast of 76,669 MW the no-wind scenario results in a projected 2022 Reserve Margin of 16.18 percent. *See* http://www.ercot.com/content/wcm/lists/219841/CapacityDemandandReservesReport_May2021.xlsx.

Optimal Reserve Margin.[9] Likewise, assuming zero wind and solar resources over the Winter 2022-2023 peak,[10] the CDR projects a Reserve Margin of 23.97 percent, exceeding the current target and the Economically Optimal Reserve Margin.

Some participants in this process have jumped to the conclusion that the current ERCOT market is incapable of attracting new investment in dispatchable resources. This conclusion is contradicted by testimony presented to the Senate Committee on Business and Commerce at its recent hearing on September 28, 2021. At that hearing, Mike Alvarado, President of Watt Bridge, testified that his company is in the process of investing in 4,000 MW of dispatchable natural gas resources in ERCOT by 2025, with 1,536 MW being operational by year-end 2021. Those resources are not currently fully reflected in the CDR, which suggests an even higher Reserve Margin than reported. Mr. Alvarado testified that the investments will take place under current regulatory standards without market design changes or subsidies. His testimony suggests that new investment in natural gas peaking generation may well be attracted to the ERCOT market when stable, predictable market conditions support the investment.[11]

OCSC raises these observations to make clear that the Commission should not feel pressed into making a hasty decision on the LSE Capacity Obligation proposal. Capacity markets fundamentally raise costs to consumers, and the missing piece of the Commission's discussions on this restructuring is its impact on the costs to consumers. Neither the Commission nor the stakeholders had an opportunity to evaluate whether and how the LSE Capacity Obligation integrates with the ERCOT market design. Much like in the two major prior ERCOT market designs, the Commission should take the time to assess all the alternatives, fully review the capacity market obligations in place in other regions, and allow the Brattle Group to complete and publish for review a full economic assessment. Only then can the stakeholders provide a fair and balanced response to the proposed design.

The Commission's ongoing process is fundamentally imbalanced, with significant advantage to the largest entities with the resources to engage high-priced consultants. In the past,

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[9] *See* http://www.ercot.com/content/wcm/lists/219841/CapacityDemandandReservesReport_May2021.xlsx.

[10] *Id.* Assuming zero wind and solar capability in the most recent CDR winter 2022/2023 forecast will reduce Total Capacity by 11,173 MW to a forecasted Total Capacity of 76,640 MW. Based on a Firm Peak Load forecast of 61,821 MW, the no wind and no solar scenario results in a projected 2022/2023 Reserve Margin of 23.97 percent.

[11] Senate Committee on Business & Commerce, 87th Leg., 3d C.S., Hearing (Sept. 28, 2021).

smaller entities were able to rely on the Commission to create a robust and transparent decision environment that helped to level out the playing field for all Market Participants. The Commission itself brought in multiple industry experts to make recommendations and share the analytic results with the Commission and the stakeholders. That approach allows all Market Participants a better opportunity to understand and react to the proposed market changes.

III. CONCLUSION

OCSC recommends the Commission focus on operational improvements rather than premature changes to the market design. In addition, OCSC does not support moving ahead with the proposed LSE Capacity Obligation insofar as there is neither an imminent capacity shortage nor was capacity insufficiency the cause of the winter outage. The complex, fundamental market design issues under consideration merit full study, consideration of alternatives and comprehensive cost assessment. These decisions require a comprehensive design and assessment process, which cannot be completed by the end of this year.

OCSC looks forward to future work sessions, discussions, and opportunities for stakeholder engagement regarding the review of the wholesale electric market design, and appreciates the opportunity to submit these Comments to the Commission.

Dated: November 1, 2021

Respectfully submitted,

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ATTORNEYS FOR STEERING COMMITTEE OF CITIES SERVED BY ONCOR

CERTIFICATE OF SERVICE

I certify that, unless otherwise ordered by the presiding officer, notice of the filing of this document was provided to all parties of record via electronic mail on November 1, 2021, in accordance with the Order Suspending Rules, issued in Project No. 50664.

THOMAS L. BROCATO

Executive Summary: The Steering Committee of Cities Served by Oncor

In this project, the Commission is addressing fundamental, complex market design issues that merit full study, consideration of alternatives and comprehensive cost assessment. OCSC is not convinced that the effort underway will deliver reliable power at the lowest cost without a fuller, more structured, and more inclusive process.

The outages resulting from Winter Storm Uri were caused by a failure to winterize power plants. The Commission has taken steps to correct operations to address the failures that led directly to the winter outage. OCSC recommends the Commission continue to expand its focus on *operational policies* that directly address the causes and consequences of the winter storm outages. The new winterization rules and identification of critical natural gas loads are key to that response. Specific additional steps that should be taken are outlined in these comments.

OCSC does not support moving ahead with the proposed LSE Capacity Obligation. This is because it has not been demonstrated that ERCOT suffers from an imminent capacity sufficiency crisis, and it has not been established that capacity insufficiency caused the winter outage. While there were many contributors to the outage, the root causes were natural gas availability and the lack of power plant winterization. It is not clear that more resources would have prevented the outage without improved winterization and additional gas supply. Significantly, ERCOT's most recent projections for the upcoming winter and for the summer of 2022 suggest strong reserve margins, even when the estimates are adjusted to exclude intermittent resources. Moreover, capacity markets fundamentally raise costs to consumers, and the missing piece of the Commission's discussions on this restructuring is its impact on the costs to consumers.

OCSC recommends the Commission focus on operational improvements rather than unnecessary changes to the market design. There is neither an imminent capacity shortage nor was capacity insufficiency the cause of the winter outage. Additionally, the Commission's ongoing process is fundamentally imbalanced, with significant advantage to the largest entities with the resources to engage high-priced consultants. In the past, smaller entities were able to rely on the Commission to create a robust and transparent decision environment that helped to level out the playing field for all Market Participants. The complex, fundamental market design issues under consideration merit full study, consideration of alternatives and comprehensive cost assessment. These decisions require a comprehensive design and assessment process, which cannot be completed by the end of this year.